Corporate Governance, Intellectual Capital, and Financial Performance

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A B S T R A C T

These studies provide empirical evidence related to intellectual capital disclosure, corporate governance, and firm financial performance. The sample is manufacturing company listed in IDX for 2015 - 2017 period. The analysis technique is regression. This study founds that independent commissioners, external auditor, managerial ownership, and relational capital disclosure has a positive effect on financial performance. Otherwise, human capital disclosure, structural capital disclosure, and audit committee disclosure has no effect.

1. Introduction

The financial crisis of 1997 – 1998 has always been a frightening scourge of the Indonesian people because of the many corrupt practices that made economic conditions instability at that time. Learning from this incident, the government carried out financial reforms and succeeded in making Indonesia's economic condition relatively stable when facing the 2008 financial crisis. The financial reform is the establishment of *corporate governance*.

Governance is a *framework* of several factors, namely institutional, legal and cultural that form the pattern of influence of *stakeholders* when making managerial decisions (Borges Júnior, 2022). Corporate governance has succeeded in becoming the basis of rules to control company management in good management so as to generate added value for stakeholders (Abang'a et al., 2022). Some elements of good governance are the ownership of management, independent commissioners, audit committees, and external auditors in the company (Asni &Agustia, 2022; Dalwai &Mohammadi, 2020; Moudud-Ul-Huq et al., 2020). Governance practices contribute to the achievement of high financial performance (Kasbar et al., 2022).

High financial performance is not only supported by governance, but also the empowerment of intellectual resources as one of the company's intangible assets (Dalwai &Mohammadi, 2020). The treatment and disclosure of intellectual resources is discussed in PSAK No 19 on intangible assets. The existence of intellectual resources produces *sustainable* company value because their thinking can lead the company to be able to compete with competitors in the industry.

Unfortunately, there are still few companies that are aware of uncovering their intellectual resources because there are no rules governing such disclosures (Ulum et al., 2016).

Agency theory reveals that there must be a balance in managerial structures so that information asymmetry does not occur (Jensen &Meckling, 1976). Therefore, the presence of governance is a response to become a bridge to that balance. In addition, the voluntary disclosure of intellectual resources is also a bridge to the balance of information asymmetry in management. This thinking is increasingly supported by the theory of stakeholders that companies must be able to carry out effective management to achieve their goals, one way is the implementation of governance and the presence of intellectual resources (Freeman, 1984; R. E. Freeman et al., 2010; Hörisch et al., 2020).

The research sample is a manufacturing company on the Indonesia Stock Exchange for the observation year 2015 – 2017. The purpose of the study is to provide empirical evidence of the influence of governance and intellectual resources on the financial performance of corporations. The research findings show that *relational capital disclosure*, managerial ownership, independent commissioners, and external auditors have a positive effect on the financial performance of the corporation. In contrast, *human capital disclosure*, *structural capital disclosure* and audit committees do not affect financial performance. The contribution of this study consists of two. First, for the development of agency and *stakeholder* theory by complementing the results of previous studies related to research on the company's financial performance. Second, the company's management to consider *relational capital disclosure* to improve the company's financial performance.

2. Theoretical Background

The rationale for research is formulated from two views, namely *stakeholders* theory, and agency theory that intersect with each other. Stakeholders theory is closely related to corporate governance in order to achieve corporate goals because it explains the behavior of managers in carrying out their responsibilities (Freeman, 1984). The performance of a manager will affect the performance of his company (R. E. Freeman et al., 2010). This theory emphasizes accountability where managers will choose to make voluntary disclosures related to intellectual, social and environmental performance in addition to mandatory disclosures to satisfy shareholder expectations. On the other hand, agency theory encourages managers to have voluntary disclosure initiatives to reduce information asymmetry and give owners confidence that company resources are being used optimally (Goebel, 2018).

Mahrani & Soewarno (2018), Chen et al. (2014) and Fuenzalida et al. (2013) prove independent commissioners have a positive influence on corporate financial performance. Independent commissioners as an element of governance have an independent nature from management. Therefore their supervision is more stringent and objective. The existence of a series of professional rules that must be implemented by independent commissioners in their work makes their supervision more directed and effective. When the supervision system of a company runs well, effectively and efficiently, the resulting performance will also be optimal. Hence proposed the following hypothesis:

H_1: Independent commissioners positively affect financial performance.

In addition to the presence of independent commissioners, managerial ownership in corporate governance elements also has a positive impact on financial performance (Al-ahdal et al., 2020). The existence of management ownership does not necessarily make them arbitrary in carrying out management. Its presence actually directs management to be cautious and continue to strive to improve financial performance (Kurniati, 2019). The next proposed hypothesis is:

H_2: Managerial ownership has a positive effect on financial performance.

Another important governance element is the audit committee. He is responsible for supervising financial statements, internal control of the company and ensuring audit results (Lajmi &Yab, 2021). Seeing the many responsibilities of the audit committee, the more proportion it will improve financial performance because their strict supervision is a trigger for management to do optimal work in order to be assessed well by the audit committee (Dalwai &Mohammadi, 2020). Based on these thoughts, a hypothesis was formulated:

H_3: The audit committee has a positive effect on financial performance.

The elements of governance are not only from the internal side. There is an external element, namely the external auditor. External auditors are required to be competent and independent in carrying out their examinations (La Torre et al., 2021). Therefore, the company's management will try their best to produce superior and reliable performance in order to get a good opinion from external auditors. The hypothesis four proposed are:

H_4: External auditors positively affect financial performance.

Intellectual resources are difficult to define because they are dynamic and abstract in nature (Prasojo &Hadinata, 2020). However, there are several researchers who discuss its definition, namely Ning Dalwai & Mohammadi (2020), mentioning it as a resource to generate competitive advantages so as to improve financial performance. Riahi-Belkaoui (2003) adds there are three elements of intellectual resources: *human capital; structural capital; and customer capital*. The disclosure of such elements in the annual report is voluntary based on the awareness of each management. The reason why the company regrets this is to maintain the quality of employees and convince management that the company has good resources to be able to manage operations superiorly (Vo et al., 2022). The management of intellectual resources ultimately succeeded in improving the company's financial performance (Bataineh et al., 2022). Based on this, the following hypotheses are formulated:

H_5: Disclosure of *human capital* affects financial performance.

H_6: Disclosure of *structural capital* affects financial performance.

H_7: Disclosure of *customer capital* affects financial performance.

3. Research Methodology

The research sample is the manufacturing industry that listed on the Indonesia Stock Exchange for the period 2015-2017 . The source of data used is information in the publication of the company's annual report on the *www.idx.co.id* website or official website of each company. The initial sample consisted of 441 observations. The corporation neither publishes annual reports nor does it present any required information data so that 309 remain as final observations.

Financial performance (dependent variable) is measured by *return on assets* (ROA). This size was chosen because it includes *both tangible* and *intangible* assets (intellectual resources) that are suitable for accommodating research objectives. Corporate governance is proxied by an independent commissioner; managerial ownership; audit committee and external auditors. Riahi (2003) revealed that intellectual resources are a combination of *human capital, structural* capital and *relational capital*.

Human capital is interpreted as a company value derived from the knowledge gained by the employee even after he or she nolonger works at the company (Shaaban, 2022; Ulum, 2015). *Structural capital* is the value of the company obtained from detailed company knowledge about technology, innovation, data, publications, strategy and culture (Onuoha, 2021; Ulum et al., 2016). Meanwhile, *relational capital* is the company's value from franchising, market share, customer retention and the profit of each customer (Pant et al., 2022). Based on Ulum (2015) disclosure of intellectual resources identified using a *four way numerical coding system*, namely with a series of items, 0 if the item is not revealed in the annual report; 1 if the item revealed in the *annual report* is in the form of a narrative; 2 if the item is revealed it will berbefor numeric and 3 if the item is revealed in monetary units. Next from the items revealed, an index score is made to provide numbers for each component by referring to the formula Baldini & Liberatore (2016). Table 1 describes the size of the research variables.

Table 1.
Variable Calculation

Variable	Size
Return on Assets	Net income : Total Assets
KomInd	∑Independent Commissioner : ∑Member of the Board of Commissioners
KepMen	∑shares belonging to the board of directors: ∑shares of the company
KomAud	Number of audit committees
AudEks	Dummy, 1 if the report is audited by KAP Big4 and 0 other than
HCD	∑human capital item disclosure score : cumulative number of HCD items
SCD	∑capital structural item disclosure score : cumulative number of SCD items
RCD	∑relational capital item disclosure score : cumulative number of RCD items

multiple linear regretion is used as a research data analysis technique with the model:

$$ROA = a + b_1KomInd + b\ {}_2KepMen + b\ {}_3KomAud + b\ {}_4AudEks + \beta\ {}_5HCD + b_6SCD + \beta\ 7\ RCD + \varepsilon$$

Where ROA is a *return on assets*. α is a constant. β_{1-7} is the regression coefficient X_{1-7}; ε = error.

4. Results and Discussion

Table 2 shows descriptive statistics that the average independent commissioner in the study sample consisted of 0.416. The average managerial ownership was 0.069. Audit committee with an average score of 3,071. External auditor with an average value of 0.462. HCD; SCD; and RCD with an average value of 0.572; 0.545; and 0.594. Financial performance with an average value of 0.043. Multicoleniarity testing provesthat there is no multicoleniarity problem because all research variables have aVIF value of < 10 (table 3).

Based on the results of the linear regression of the homepage in figure 4, it is known that independent commissioners, managerial ownership, external auditors and RCDs have a positive effect on the financial performance of the corporation. The hypotheses H_1, H_2, H_4, H_7 are accepted. This means that the representation of independent commissioners, managerial ownership, and external auditors as a corporate governance mechanism can be a tool to optimize the company's financial performance. These findings support Al-ahdal et al. (2020), Mahrani & Soewarno (2018), Bataineh et al. (2022) , Dalwai & Mohammadi (2020).

Table 2.
Descriptive Statistics

	Total Observations	Min	Max	Mean	Std Dev
KomInd	309	0.170	1.000	0.410	0.100
KepMen	309	0.000	2.630	0.000	0.210
KomAud	309	1.000	5.000	3.070	0.400
AudEks	309	0.000	1.000	0.460	0.490
HCD	309	0.290	0.930	0.570	0.160
SCD	309	0.210	0.750	0.540	0.000
RCD	309	0.270	0.910	0.500	0.130
ROA	309	-1. 280	0.530	0.040	0.110

Source: Processed Data, 2022.

In line with agency theory, the supervisory role of independent commissioners is able to maintain the work of company management to be able to optimize company resources in order to achieve high performance (Jensen &Meckling, 1976). The existence of managerial ownership motivates the board of directors to give their best work because it will affect itself so that the company's performance is produced higher. The role of external auditors has proven to be able to improve the company's financial performance because management is motivated to get a fair opinion without exception for its financial statements (Kassem, 2021).

Research findings prove that a company's financial performance is influenced by an individual or group of people, namely independent commissioners, and external auditors because their representation strengthens the trust of stakeholders (Freeman, 1984; R. E. Freeman et al., 2010). This is in line with the thinking of theoretical stakeholders. In addition, disclosure of *relational capital* is defined as an effective strategy to win the trust of *stakeholders*. Management strives to continue to establish good relationships with consumers, suppliers, creditors, investors, the public and the government by presenting disclosure of *relational capital* and providing their best performance so as to satisfy all *stakeholders*.

Table 3.
Multikolenieritas

	BRIGHT
KomInd	1.041
KepMen	1.033
KomAud	1.096
AudEks	1.254
HCD	1.576
SCD	1.570
RCD	1.560

Source: Processed Data, 2022.

Table 4.
Results of Multiple Linear Regression Analysis

	B	t
Const	-0.218	-3.691
KomInd	0.166	3.681*
KepMen	0.113	2.392**
KomAud	0.012	0.726
AudEks	0.023	2.373**
HCD	0.037	1.110
SCD	0.068	1.037
RCD	0.143	3.421*

The * and ** signs mean significant at the level of 1% and 5%
Source: Processed Data, 2022.

The audit committee, HCD and SCD have no effect on financial performance (table 4). H_3, H_5, and H_6 are rejected. The ineffectiveness of supervision carried out by the audit committee is the reason why it does not affect financial performance (Kabito, 2021). In line with stakeholders' theory, the audit committee is not the right element to encourage the management of company finances because its authority is less directly involved in the management of the company (Abdulah &Tursoy, 2022; Freeman, 1984). Furthermore, still from the perspective of stakeholders' theory, the non-maximum disclosure of information related to HCD is the reason for the failure of this disclosure to encourage improved financial performance (R. E. Freeman et al., 2010). HR management practices are not yet effective due to the large cost of HR management while information related to *human capital* still does not receive much attention for users of reports, both investors, creditors and not comparable to the costs incurred by the company so that many companies choose to allocate HR management funds for other things.

In line with Seyed et al. (2012), SCD has no effect on financial performance because the company prefers other aspects as its focus. Structural capital is influenced by internal changes in the company as a whole, causing large costs in its changes, while the disclosure of information related to SCD is still unable to influence stakeholder confidence in the condition of the company because the completeness of information is still not optimal so that it still contains asymmetry. The wealth of intellectual capital whose information often contains too detailed information related to the company's advantages is considered harmful so that management minimizes the disclosure of information related to *intellectual* capital , especially *structural capital* which consists of many items that need to be disclosed.

5. Conclusion

The purpose of this study provides empirical evidence of the influence of governance and intellectual resources on corporate financial performance. The research findings show that managerial ownership, independent commissioners, RCDs and external auditors have a positive effect on the financial performance of the corporation. In contrast the audit committee, HCD and SCD do not affect financial performance. Research implications for company management to consider *relational capital disclosure* and apply elements of corporate governance, namely independent commissioners, managerial leadership and external auditors in order to improve the financial performance of the corporation.

The large number of manufacturing companies that do not publish disclosures of information related to intellectual resources needed in research is the limitation of research. Therefore, the next research suggestion is to add other modification items in the disclosure of intellectual resources so that the research data is more comprehensive.

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